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Stakeholders

Municipal Securities
Dealers, Issuers, Investors,
General Public

Notice Type

Informational Notice

Compliance Date

June 1, 2024

Category

Fair Practice

Affected Rules

[Rule G-27](#)

MSRB Amends Rule G-27 to Adopt the Residential Supervisory Location Classification Consistent with FINRA Dealer Supervision Provisions

Overview

On May 10, 2024, the Municipal Securities Rulemaking Board (“MSRB”) filed with the U.S. Securities and Exchange Commission (“Commission”)¹ a proposed rule change to amend MSRB Rule G-27, on supervision, to permit certain brokers, dealers, and municipal securities dealers (“dealers”) that are members of the Financial Industry Regulatory Authority (“FINRA”) to classify an associated person’s private residence solely engaged in specified supervisory activities as a non-branch location, if certain conditions are met. The amendment creating this new category of private residences, the residential supervisory location (“RSL”), under new Supplementary Material .04 of Rule G-27, is designed to harmonize Rule G-27 with recently adopted amendments to FINRA Rule 3110, on supervision.²

The proposed rule change was filed for immediate effectiveness and the MSRB has requested that the Commission make it operative on June 1, 2024, to coincide with the effectiveness of FINRA’s RSL provisions. The MSRB expects to propose in the near future an additional rule change to similarly harmonize Rule G-27 with the recently adopted FINRA remote inspection pilot program under FINRA Rule 3110³ through a separate filing with the Commission.

¹ [File No. SR-MSRB-2024-04](#).

² See Exchange Act Release No. 98980 (November 17, 2023), 88 FR 82447 (November 24, 2023).

³ See Exchange Act Release No. 98982 (November 17, 2023), 88 FR 82464 (November 24, 2023).



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Summary of the Amendment

The new RSL classification promotes regulatory consistency for dealers that are both FINRA members and MSRB registrants and must therefore comply with MSRB and FINRA rules. The amendment would not apply to dealers that are not members of FINRA, including bank dealers.⁴

The RSL classification allows dealers the option to treat a private residence at which an associated person engages in specified supervisory activities, subject to certain safeguards and limitations, as a non-branch location. As a non-branch location, RSLs would be subject to inspections on a regular periodic schedule instead of the annual inspection currently required for OMSJs and supervisory branch offices.⁵

In order to utilize the optional RSL classification in accordance with the new Supplementary Material .04, a dealer and the associated person at each location must meet specified conditions and eligibility requirements at both the firm level and location level. Additionally, the dealer must develop a reasonable risk-based approach to designating a location as an RSL, and conduct and document a risk assessment for the associated person assigned to such office or location. The conditions and requirements for dealers wishing to utilize the RSL designation are summarized below:

Rule G-27 Supplementary Material .04(a) sets forth conditions for dealers wishing to utilize the RSL designation, mirroring those of FINRA Rule 3110.19(a). Specifically, the conditions that must be met for designating an associated person's private residence as an RSL under Supplementary Material .04(a) would include:

- (i) only one associated person, or multiple associated persons who reside at that location and are members of the same immediate family, conduct business at the location;
- (ii) the location is not held out to the public as an office;

⁴ A bank dealer is defined under MSRB Rule D-8 as a municipal securities dealer which is a bank or a separately identifiable department or division of a bank. The MSRB will consider at a later date whether or not to extend the ability to make RSL designations to bank dealers after giving due consideration to how to operationalize such initiative.

⁵ MSRB Rule G-27(d)(i)(A) requires dealers to inspect every OMSJ and any supervisory municipal branch office at least annually. MSRB Rules G-27(d)(i)(B) and G-27(d)(i)(C) require dealers to inspect every non-supervisory branch office at least every three years, and every non-branch location on a regular periodic schedule.

- (iii) the associated person does not meet with customers or prospective customers at the location;
- (iv) any sales activity that takes place at the location complies with the conditions set forth under subparagraphs (g)(ii)(A)(2) or (3) of Rule G-27;
- (v) neither customer funds nor securities are handled at that location;
- (vi) the associated person is assigned to a designated branch office, in accordance with Rule G-27(g)(ii), on municipal branch office, and such designated branch office is reflected on all business cards, stationery, retail communications and other communications to the public by such associated person;
- (vii) the associated person's correspondence and communications with the public are subject to the dealer's supervision in accordance with Rule G-27;
- (viii) the associated person's electronic communications (e.g., e-mail) are made through the dealer's electronic system;
- (ix) (A) the dealer must have a recordkeeping system to make, maintain, and preserve such records required to be made, maintained, and preserved under applicable securities laws and regulations, including applicable MSRB rules, and the dealer's own written supervisory procedures under Rule G-27, (B) such records are not physically or electronically maintained and preserved at the office or location; and (C) the dealer has prompt access to such records; and
- (x) the dealer must determine that its surveillance and technology tools are appropriate to supervise the types of risks presented by each RSL, which may include: (A) firm-wide electronic tools for recordkeeping, surveillance of e-mail and correspondence, trade blotter review, standard activity-based sampling reviews, and tools for visual inspections; (B) tools specific to carrying out supervision of such RSL based on the activities of associated persons assigned to the location, products offered, and restrictions on the activity of the RSL; and (C) system security tools such as secure network connections and effective cybersecurity protocols.

Rule G-27 Supplementary Material .04(b) provides that a dealer would be ineligible from utilizing the RSL designation under MSRB rules if the dealer is not a FINRA member or fails to satisfy the prescribed requirements of FINRA relating to its member firms' eligibility for such RSL designation as provided in FINRA Rule 3110.19(b).

Rule G-27 Supplementary Material .04(c) lists criteria that would render a specific location of a firm ineligible from utilizing the RSL designation, mirroring those of FINRA Rule 3110.19(c). Specifically, the conditions that

would make an office ineligible would include, if one or more persons at that office:

- (i) is a designated principal who has less than one year of direct supervisory experience with the dealer, or with an affiliate or subsidiary of the dealer that is registered as a dealer or investment adviser;
- (ii) is functioning as a principal for a limited period without being duly qualified under MSRB Rules G-3(b)(ii)(D), (b)(iv)(B)(4), or (c)(ii)(D);
- (iii) is subject to a mandatory heightened supervisory plan under the rules of FINRA, the Commission, or state regulatory agency;
- (iv) is statutorily disqualified, unless such disqualified person has been approved to associate with a dealer and is not subject to heightened supervision;
- (v) has an event in the prior three years that required a “yes” response to certain items relating to criminal or regulatory action disclosures on Form U4; or
- (vi) has been notified in writing that such associated person is now subject to any investigation or proceeding by the Commission, a self-regulatory organization, including FINRA, or state securities commission (each individually a “regulator” and collectively “regulators”) expressly alleging they have failed reasonably to supervise another person subject to their supervision.⁶

Rule G-27 Supplementary Material .04(d) requires dealers electing to designate any office or location of the dealer as an RSL to provide a current list of all locations designated as RSLs by the 15th day of the month following each calendar quarter in the manner and format as required by FINRA. This requirement mirrors the provisions set forth in FINRA Rule 3110.19(d).

Rule G-27 Supplementary Material .04(e) contains a requirement for dealers to develop a reasonable risk-based approach to designating an office or location as an RSL. Additionally, dealers must conduct and document a risk assessment for the associated person assigned to each location to be designated as an RSL. The assessment lists certain factors, among others,

⁶ In these instances, an office or location may be designated or redesignated as an RSL upon the earlier of: (i) the dealer’s receipt of written notification from the applicable regulator that such investigation has concluded without further action; or (ii) one year from the date of the last communication from such regulator relating to such investigation. Supplementary Material .04(c)(6) mirrors FINRA Rule 3110.19(c)(6), with non-substantive terminology changes.

that dealers must consider in the risk assessment, including whether each associated person at such location is subject to:

- (i) customer complaints, taking into account the volume and nature of the complaints;
- (ii) heightened supervision other than where such office or location is ineligible for RSL designation as determined by FINRA;
- (iii) any failure to comply with the dealer's written supervisory procedures;
- (iv) any recordkeeping violations; and
- (v) any regulatory communications from a regulator indicating that the associated person at such office or location failed reasonably to supervise another person subject to their supervision.

Additionally, pursuant to new Supplementary Material .04(e) and mirroring FINRA Rule 3110.19(e), dealers designating an office or location as an RSL would be required to consider any higher-risk activities that take place at that location, higher-risk associated person assigned to that location, and any indicators of irregularities or misconduct (i.e., "red flags"). This provision mirrors the provisions of FINRA Rule 3110.19(e) for ineligibility of locations to be designated as an RSL.

On June 1, 2024, dealers may start using the RSL designation in accordance with Supplementary Material .04 of Rule G-27. Dealers must provide a list of designated RSLs to FINRA with the first list due to FINRA by October 15, 2024, covering all locations designated between June 1, 2024, and September 30, 2024. Dealers may wish to review FINRA's Frequently Asked Questions about Residential Supervisory Locations (RSLs)⁷ for more information about complying with the requirements of FINRA Rule 3110.19, which generally form the basis for the requirements under new Supplementary Material .04 of Rule G-27 for dealers seeking to designate one or more RSLs.

Questions concerning this filing may be directed to Bri Joiner, Senior Director, Frank Mazzarelli, Director, or Justin Kramer, Assistant Director, Market Regulation, at (202) 838-1500.

May 10, 2024

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⁷ Available at <https://www.finra.org/rules-guidance/key-topics/residential-supervisory-locations/faq>.

Text of Amendment*

Rule G-27: Supervision

(a) - (g) No Change.

Supplementary Material

.01 - .03 No Change.

.04 Residential Supervisory Locations

(a) Conditions for Designation as a Residential Supervisory Location. Notwithstanding any other provisions of section (g) of Rule G-27 and subject to paragraphs (b) through (d) of this Supplementary Material, a location that is the associated person's private residence where supervisory activities are conducted, as prescribed in paragraphs (g)(i)(D) through (G) or paragraph (g)(ii)(B) of Rule G-27, shall be considered for those activities a Residential Supervisory Location ("RSL") that is a non-branch location, provided that:

- (1) only one associated person, or multiple associated persons who reside at that location and are members of the same immediate family, conduct business at the location;
- (2) the location is not held out to the public as an office;
- (3) the associated person does not meet with customers or prospective customers at the location;
- (4) any sales activity that takes place at the location complies with the conditions set forth under subparagraphs (g)(ii)(A)(2) or (3) of Rule G-27;
- (5) neither customer funds nor securities are handled at that location;
- (6) the associated person is assigned to a designated branch office, in accordance with Rule G-27(g)(ii), on municipal branch office, and such designated branch office is reflected on all business cards, stationery, retail communications and other communications to the public by such associated person;
- (7) the associated person's correspondence and communications with the public are subject to the dealer's supervision in accordance with Rule G-27;
- (8) the associated person's electronic communications (e.g., e-mail) are made through the dealer's electronic system;

* Underlining indicates new language.

(9) (A) the dealer must have a recordkeeping system to make, maintain, and preserve such records required to be made, maintained, and preserved under applicable securities laws and regulations, including applicable Board rules, and the dealer’s own written supervisory procedures under Rule G-27;

(B) such records are not physically or electronically maintained and preserved at the office or location; and

(C) the dealer has prompt access to such records; and

(10) the dealer must determine that its surveillance and technology tools are appropriate to supervise the types of risks presented by each RSL. These tools may include but are not limited to:

(A) firm-wide tools such as electronic recordkeeping systems; electronic surveillance of e-mail and correspondence; electronic or other equally effective trade blotter review; regular activity-based sampling reviews; and tools for visual inspections;

(B) tools specific to carrying out supervision of such RSL based on the activities of associated persons assigned to the location, products offered, or restrictions on the activity of the RSL; and

(C) system tools such as secure network connections and effective cybersecurity protocols.

(b) Dealer Ineligibility Criteria. A dealer shall not be eligible to designate an office or location as an RSL, in accordance with this Supplementary Material, if the dealer (1) is not a member of a registered securities association or (2) fails to satisfy the prescribed requirements of such registered securities association relating to its member firms’ eligibility for such RSL designation.

(c) Location Ineligibility Criteria. An office or location shall not be eligible for designation as an RSL in accordance with this Supplementary Material if one or more associated persons at such office or location:

(1) is a designated principal who has less than one year of direct supervisory experience with the dealer, or an affiliate or subsidiary of the dealer that is registered as a dealer or investment adviser;

(2) is functioning as a principal for a limited period in accordance with subparagraphs (b)(ii)(D), (b)(iv)(B)(4) or (c)(ii)(D) of Rule G-3;

(3) is subject to a mandatory heightened supervisory plan under the rules of a registered securities association, the Securities and Exchange Commission, or state regulatory agency;

(4) is statutorily disqualified as defined in Section 3(a)(39) of the Act, unless such disqualified person has been approved to associate with a dealer, without being subject to a mandatory heightened supervisory plan, by a registered securities association;

(5) has an event in the prior three years that required a “yes” response to any item contained in Questions 14A(1)(a) and 2(a), 14B(1)(a) and 2(a), 14C, 14D and 14E on Form U4 (Uniform Application for Securities Industry Registration or Transfer), or similar form by a registered securities association; or

(6) has been notified in writing that such associated person is now subject to any Investigation or Proceeding, as such terms are defined in the Explanation of Terms for the Form U4, by the Securities and Exchange Commission, a self-regulatory organization, or state securities commission (or agency or office performing like functions) (each, a “Regulator”) expressly alleging they have failed to reasonably supervise another person subject to their supervision, with a view to preventing the violation of any provision of the Securities Act, the Exchange Act, the Investment Advisers Act, the Investment Company Act, the Commodity Exchange Act, any state law pertaining to the regulation of securities or any rule or regulation under any of such Acts or laws, or any of the rules of the Board or other self-regulatory organization, including FINRA. Notwithstanding, such office or location may be designated or redesignated as an RSL subject to the requirements of this Supplementary Material upon the earlier of: (i) the dealer’s receipt of written notification from the applicable Regulator that such Investigation has concluded without further action; or (ii) one year from the date of the last communication from such Regulator relating to such Investigation.

(d) Obligation to Provide RSL List to Registered Securities Association. Each dealer that elects to designate any office or location of the dealer as an RSL pursuant to this Supplementary Material shall provide to the registered securities association of which it is a member a current list of all locations designated as RSLs by the 15th day of the month following each calendar quarter in the manner and format (e.g., through an electronic process or such other process) as required by such registered securities association.

(e) Risk Assessment. Subject to the requirements of this Supplementary Material, prior to designating an office or location as an RSL, the dealer must develop a reasonable risk-based approach to designating such office or location as an RSL, and conduct and document a risk assessment for the associated person(s) assigned to that office or location. The assessment must document the factors considered, including among others, whether each associated person at such office or location is now subject to:

- (1) customer complaints, taking into account the volume and nature of the complaints;
- (2) heightened supervision other than where such office or location is ineligible for RSL designation under paragraph (c)(3) of this Supplementary Material;
- (3) any failure to comply with the dealer’s written supervisory procedures;
- (4) any recordkeeping violations; and
- (5) any regulatory communications from a Regulator indicating that the associated person at such office or location may have failed reasonably to supervise another person subject to their supervision, including but not limited to, subpoenas, preliminary or routine regulatory inquiries or requests for information, deficiency letters, “blue sheet” requests or other trading questionnaires, or examinations.

The dealer must take into account any higher risk activities that take place or a higher risk associated person that is assigned to that office or location. Consistent with its obligation under Rule G-27(b), the dealer's supervisory system must take into consideration any indicators of irregularities or misconduct (i.e., "red flags") when designating an office or location as an RSL.

Red flags should also be reviewed in determining whether it is reasonable to maintain the RSL designation of such office or location in accordance with the requirements of this Supplementary Material and the dealer should consider evidencing steps taken to address those red flags where appropriate.